

VZCZCXYZ0011
RR RUEHWEB

DE RUEHQT #0820 2511056
ZNR UUUUU ZZH
R 042142Z SEP 09
FM AMEMBASSY QUITO
TO RUEHC/SECSTATE WASHDC0000
INFO RHEBAAA/DEPT OF ENERGY WASHINGTON DC
RUCPDO/DEPT OF COMMERCE WASHINGTON DC
RUEATRS/DEPT OF TREASURY WASHINGTON DC
RUEHBJ/AMEMBASSY BEIJING
RUEHBO/AMEMBASSY BOGOTA
RUEHCV/AMEMBASSY CARACAS
RUEHGL/AMCONSUL GUAYAQUIL
RUEHLP/AMEMBASSY LA PAZ
RUEHPE/AMEMBASSY LIMA
RUEHQT/AMEMBASSY QUITO

UNCLAS QUITO 000820

SENSITIVE
SIPDIS

E.O. 12958: N/A
TAGS: [ECON](#) [EPET](#) [EINV](#) [EFIN](#) [ENRG](#) [EC](#)
SUBJECT: ECUADOR SELLS FUTURE OIL PRODUCTION TO PETROCHINA TO
STRENGTHEN FISCAL ACCOUNTS

REF: 09 QUITO 351

SUMMARY

¶1. (SBU) The Government of Ecuador (GoE) is increasingly looking to China as a source of financing to help alleviate fiscal pressures. The prime example of this is Ecuadorian state-run oil firm PetroEcuador's recent agreement to sell future oil production to China's state-owned oil company PetroChina, under which the GoE received an advance payment of US\$1 billion. The GoE entered into this arrangement to ease liquidity constraints resulting from the fall in oil prices and a major expansion in government expenditures. The GoE is negotiating for an additional US\$ 1 billion credit from China, and private sector sources tell Post the full advance payment could total US\$ 3 billion. Private analysts worry that this non-transparent and seemingly expensive deal, comprising 34% of Ecuador's oil production through July 2010, prioritizes current expenditures at the expense of future revenues and fiscal solvency. End Summary.

PetroChina US\$ 1bn Advance Payment for Ecuadoran Oil

¶2. (SBU) According to the agreement signed July 27, 2009 between PetroChina and PetroEcuador, PetroChina will purchase 69 million barrels over two years at a rate of approximately 95,000 barrels per day (bpd). The price for each shipment of crude will be determined by the prevailing market price. Under the agreement, the GoE received an advance payment of \$1 billion from PetroChina in early August. The annual interest rate on the \$1 billion advance will be 7.25%.

¶3. (SBU) PetroEcuador announced at the time of the signing that PetroChina will discount approximately 28% of the cost of each

barrel exported as payment on the advance, in effect leaving PetroEcuador and the GoE 72% of the value of exports to PetroChina. PetroEcuador officials explained to the Embassy that this calculation is based on an average oil/barrel price of \$60 over the next two years, and that this percentage breakdown will adjust to account for changes to the price of Ecuadoran oil. According to the contract, China will be the final consumer of the oil and will not be able to resell it to other countries.

¶4. (SBU) This deal compromises roughly 20% of Ecuador's oil production over the next couple of years, and China will leap ahead of other export markets to become Ecuador's second largest market after the U.S (based on 2008 statistics). According to Central Bank data, from January to June 2009 Ecuador exported 59.73 million barrels of oil, down from 66.21 million barrels during the same period in 2008. In 2008, almost 62% of Ecuador's total oil exports were to the U.S., almost 16% to Peru, and about 15% to Chile. Oil exports to China in 2008 comprised only 2.24% of the total, ranking China as Ecuador's fifth largest buyer of crude oil. (Total oil production reached approximately 185 million barrels in 2008 and is projected at about 176 million barrels for 2009.)

Rumors of Additional PetroChina Advances

¶5. (SBU) In addition to the \$1 billion advance on oil supplies received in early August, Foreign Minister Falconi stated August 16 that the GoE is negotiating a second \$1 billion credit with China. At the time of the announcement, Falconi did not clarify whether this would be an unsecured loan or also an advance on future oil sales. However, GoE Coordinating Minister for Economic Policy, Diego Borja, commented recently to the press that the GoE's Chinese counterparts have tried to condition this credit to oil sales. He said that this demand was unacceptable to the GoE and that GoE authorities are waiting for the Chinese response to their counterproposal. (Comment: Post's financial sector contacts say that GoE officials expect up to a total of US\$ 3 billion from PetroChina, likely as an advance on the two-year oil sales agreement.)

Conflicting Statements over Usage of Funds

¶6. (SBU) GoE statements regarding the use of this advance (and any additional advances) have varied widely. The Head of PetroEcuador stated publicly that the payment will fund PetroEcuador's investment program for 2009. However, Minister Diego Borja has stated that the advance will support the creation of a Contingency Fund to assure investment in the productive sector in 2010. Both statements conflict with President Correa's public assertion that the advance will bolster GoE fiscal accounts and alleviate the current liquidity shortage.

¶7. (SBU) Private analysts argue that the GoE's fragile fiscal situation is largely the result of high growth in spending, exacerbated by the GoE's global bonds repurchase in May 2009 (reftel) following its sovereign default in December 2008. The GoE has no access to private capital markets as a result of the default and the global financial crisis. It recently received credits from the Latin American Reserve Fund (FLAR) and the Andean Development

Corporation (CAF) amounting to about US\$ 1 billion and is hoping to receive new loans from the Inter-American Development Bank (IDB). Private analysts tell the Embassy that the official credits from multilateral lenders and the PetroChina advance will not be sufficient to close the GoE's financing gap through the end of the year.

----- --
Critics Note High Cost and Lack of Transparency
----- --

¶8. (SBU) This deal has been roundly criticized by the Ecuadoran private sector and in the local press. Numerous critics have cited the high cost of the arrangement as the main drawback: the interest paid of 7.25% on the prepayment is significantly higher than that charged by CAF, FLAR, or the IDB. Rene Ortiz, a former president of the Association of Hydrocarbon Industries, said that a loan advance of this type is always more costly than lending available from multilaterals.

¶9. (SBU) Critics have also highlighted the lack of transparency in the deal. For example, Luis Calero, a recognized oil sector analyst, points out that the transaction was made without an international tender, making it impossible to determine whether Ecuador obtained the most favorable terms. Numerous other private sector critics have also noted that the payment advance means that oil revenues will be reduced over the next two years, and there is no sign that the mounting fiscal pressures will subside during this period. Augusto Tandazo, an oil industry lawyer, comments that the GoE's interest in the deal is the direct result of Ecuador's fiscal crisis and isolation from international credit markets.

----- --
Comment: Short-Term Fix to GoE Fiscal Problems
----- --

¶10. (SBU) The PetroChina loan to the GoE, along with FLAR and CAF funding and the GoE's decree forcing private banks to repatriate a portion of capital held overseas, may be sufficient or close to sufficient to cover the 2009 fiscal gap caused by the fall in oil prices. These new revenues and higher oil prices also seem to have staved off immediate concerns about the sustainability of dollarization. However, they may also encourage the GoE to continue in the short term with its current pattern of government expenditures. With this deal, the GoE is clearly prioritizing today's expenditures at the expense of future fiscal stability, and serious questions remain about how the GoE will meet its financing needs in 2010 and later years.

HODGES